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UBS to Close Down Its Municipal Bond Dept.

Swiss Giant Looking to Sell Muni Business

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By Dakin Campbell

Swiss banking giant UBS AG said yesterday it will move a portion of the institutional municipal securities group into the bank's wealth management division as part of a secondary market business that will continue to serve the bank's wealth management clients. This will be done after it either closes or sells the remainder of its municipal bond shop.

The unit is likely to include about one hundred traders and other personnel, out of the 323 that now work in the municipal securities group, according to the publisher of The Bond Buyer's Municipal Marketplace. The secondary market unit will support about 8,200 financial advisers and more than 2 million clients, according to the bank.

"UBS Wealth Management clients will continue to have access to a wide range of municipal securities for their portfolios," the bank said in a statement yesterday. "Moving select municipal trading desks into Wealth Management Americas helps provide clients access to robust secondary inventory."

The bank confirmed reports that it will exit or sell the institutional municipal securities group in an effort to focus on core client businesses after yesterday reporting first-quarter 2008 losses of $11 billion. The fixed-income, currencies, and commodities business of the investment bank, of which the municipal business is part, was most severely affected by recent market dislocation, the bank said in its first quarter financial report.

The firm's leadership told employees of the municipal securities group in a phone call late Monday that UBS would close down the muni bond department, officially putting the group on the selling block Tuesday. The announcement took many in the municipal market by surprise.

"The only thing I can compare it to is the shock when Salomon Brothers left the market [on Oct. 12, 1987]," said Peter Shapiro, managing director at Swap Financial Group. "UBS has consistently been a leader in this market and to see a firm of its prestige and its quality and its market reach just to pull the plug like this is astounding."

Though there were internal rumors about the announcement and sale, many employees were surprised.

"There had been some rumors, but there are always rumors," said one person within the bank. "Firms don't pick up and leave public finance all the time."

In the first quarter of 2008, UBS was ranked third among senior managers, capturing a 9.3% market share, or $7.6 billion in par through 89 deals, according to Thomson Reuters data. Last year, UBS was the third-busiest senior manager of municipal deals, working on 614 issues for total par of $36.3 billion.

The firm is actively seeking a buyer for the remaining municipal business and though no announcement has been made, large regional banks or other foreign banks that see a profit potential in municipals -some of which have recently gotten more involved in providing letters of credit - may be interested in the business.

"We're seeing new names in the [letter of credit] arena that we haven't before," said Michael Marz, vice chairman of the capital markets group at First Southwest Co. "That would be an obvious entry."

During the inter-departmental call Monday, employees were urged to continue working and pursuing deals in an effort to boost the unit's appeal and help find a buyer.

After a round of some 40 staff cuts in April 2007, morale in the municipal department continued to decline as some sensed UBS would further trim or cut the unit, according to sources. UBS had previously moved municipals into the investment bank in 2006 from its traditional spot in its wealth management area.

The paired announcement of both closing the muni department and putting it up for sale struck some market participants as odd since many buyers would likely wait to hire top producers without taking on the unit's liabilities.

However, one market source said it makes sense if the bank wants to keep employees to sweeten a potential sale. Employees expecting a severance payment if the department is disbanded may stay on, foiling competitors tempted to hire only the best producers. In this way, potential buyers would be more inclined to purchase the entire department rather than cherry-pick the best producers, the source said.

There is currently little guidance of how such a scenario would play out, said a person within the bank.

UBS AG entered the U.S. municipal market on Nov. 3, 2000 with its purchase of

PaineWebber Inc., a full-service securities firm with a municipal bond department that ranked as the second-busiest senior manager of municipal bonds, according to Thomson Reuters. UBS AG was formed with the merger of the Union Bank of Switzerland and Swiss Bank Corp. in 1998.

Following the acquisition of PaineWebber, the head of that firm's muni department, Terry Atkinson, spent much time getting his new Swiss superiors comfortable with the importance of a municipal bonds practice, according to The Bond Buyer's interview with Atkinson last year.

The latest news may be an illustration of that same lack of understanding, as compared to many domestic banks with executives experienced in U. S. public finance, market sources said.

"I have to believe that the fact that they are in Switzerland had some potentially negative impact," Shapiro said. "This happened with Credit Suisse First Boston when the Swiss owners said they didn't want to be in the business anymore."

The firm's departure could also further concentrate the muni business among a shrinking number of firms, as two other top-ranked underwriters, JPMorgan and Bear, Stearns & Co., are combining their businesses following JPMorgan's bailout of Bear earlier this year.

"This year we've had two of the top seven dealers disappear," Marz said. "In the short run that is not a plus for liquidity."

UBS' announcement comes as the bank evaluates its business operations, and the level of risk in the business of each department. More than 2,600 employees are expected to be cut from the investment bank, as part of a total of 5,500 job cuts , as UBS reduces its operations in the businesses it deems most risky, such as fixed-income.

Though the muni business has not suffered the crippling blows that afflicted the structured and mortgage banking businesses, the sector still faces a series of investigations and lawsuits over compliance. It has also become much more difficult to hedge municipal exposure in recent months, as typical hedging strategies that harness the correlation between munis and different markets, like Treasuries, has broken down.

"In munis even if you are taking risk it is very difficult to hedge, especially if you were using Treasuries," said Michael Imhoff, a managing director for institutional trading and underwriting at Stifel, Nicolaus & Co. "Until recently, it was very difficult to do without getting hurt."

As a European bank, UBS employs risk managers that evaluate credit risk primarily in terms of expected loss, which incorporates estimates of both the likelihood of default and the loss incurred in the event of a default, according to the bank's letter to Moody's Investors Service concerning the rating agency's efforts to employ a global ratings scale.

One challenge to evaluating the risk inherent in the municipal market - especially for executives of a European bank without significant U.S. public finance experience - is translating the municipal ratings scale and muni credit risk into something that can be compared all other fixed income sectors.

UBS will likely shut the business down and move the secondary market unit to wealth management after a few weeks if a deal is not finalized, said a source within the bank.

Yvette Shields contributed to this story.